

STATE OF MICHIGAN
IN THE SUPREME COURT

EARL H. ALLARD, JR.,
Plaintiff-Appellant,

Supreme Court No. 150891

v

Court of Appeals No. 308194

CHRISTINE A. ALLARD,
Defendant-Appellee.

Wayne County
Circuit Court Case No. 10-110358-DM

**AMICUS CURIAE BRIEF
OF THE BUSINESS LAW SECTION
OF THE STATE BAR OF MICHIGAN**

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STATEMENT OF BASIS OF JURISDICTION

Amicus curiae accepts the Statement of Appellate Jurisdiction set forth at page vii of Plaintiff-Appellant's Brief on Appeal.

STATEMENT OF QUESTIONS PRESENTED

QUESTION 1

Are MCL 552.23 and MCL 552.401 inapplicable where the parties entered into an antenuptial agreement?

Plaintiff-Appellant's Answer:	Yes.
Defendant-Appellee's Answer:	No.
Trial Court's Answer:	Yes.
Court of Appeals' Answer:	Yes.
Amicus Curiae's Answer:	Issue not addressed by this Amicus Curiae.

QUESTION 2

May the real estate held by the Plaintiff-Appellant's limited liability companies, including the marital home, and any income generated by those properties, be treated as marital assets and, if so, under what conditions?

Plaintiff-Appellant's Answer:	No.
Defendant-Appellee's Answer:	Yes.
Trial Court's Answer:	No.
Court of Appeals' Answer:	Yes.
Amicus Curiae's Answer:	No, but the LLC interests themselves are personal property of the member and therefore may be considered as a marital asset depending how the membership interests are acquired, how the membership interests are held, and how the provisions of any nuptial agreement between the spouses address personal property. Also, distributions made by the LLCs to their owners may be considered marital income even though the income produced by the LLCs themselves cannot be a marital asset.

INTEREST OF AMICUS CURIAE

The Business Law Section of the State Bar of Michigan files this brief amicus curiae pursuant to the June 10, 2015 invitation of the Supreme Court of Michigan. This Court in its Order granting leave for this appeal stated:

The parties shall include among the issues to be briefed: (1) whether MCL 552.23 and MCL 552.401 are inapplicable where the parties entered into an antenuptial agreement; and (2) whether the real estate held by the plaintiff's limited liability companies, including the marital home, and any income generated by those properties, could be treated as marital assets and, if so, under what conditions.¹

Only the second question is within the jurisdiction of the Business Law Section and is addressed in this brief.

¹ Michigan Supreme Court Order Docket Number 150891.

REQUIRED STATEMENT AND REPORT OF AMICUS CURIAE
REGARDING POSITION TAKEN

The Business Law Section is a Section of the State Bar of Michigan whose members join voluntarily based on common professional interest. It does not speak for the State Bar of Michigan. The positions expressed in this brief are those of the Business Law Section only, and are not the position of the State Bar of Michigan. To date, the State Bar of Michigan does not have a position on this matter.

The Business Law Section currently has about 3,500 members and the affairs of the Section are administered by an elected Council. The preparation of this brief on behalf of the Section was initially approved by the Council after discussions at a meeting held in conformance with the Section's bylaws on September 26, 2015. The positions taken in this brief were formally adopted by a vote of the Council after discussion at a meeting held in conformance with the Section's bylaws on December 5, 2015. On December 5, 2015, the Council consisted of 13 members (due to the resignation of 2 Council members). Of the 8 Council members who attended the December 5, 2015 meeting, 8 voted in favor of the positions that are presented in this amicus brief, 0 abstained, and 0 voted against.

The subject matter of the positions taken in this Brief is within the jurisdiction of the Business Law Section, and the positions taken in this Brief were adopted in accordance with the Section's bylaws. The requirements of State Bar of Michigan Bylaw Article VIII have been satisfied.

The required report from the Business Section of the State Bar of Michigan is provided in the next two pages.



BUSINESS LAW SECTION

Report on Public Policy Position

Name of section: Business Law Section

Contact person: Douglas L. Toering, Section Chair

E-mail: dltoering@toeringlaw.com

Amicus Curiae: Amicus brief in *Allard v. Allard*

Date position was adopted: December 5, 2015

Process used to take the ideological position: Position adopted after discussion and vote at a regular meeting.

Number of members in the decision-making body: Normally 15, currently 13.

Number who voted in favor and opposed to the position:

8 Voted for position

0 Voted against position

0 Abstained from voting

5 Were not present to vote

Position:

The Michigan Supreme Court requested that the Business Law Section submit an amicus brief to address the issues raised by the case of *Allard v. Allard*. Two issues are raised in the appeal: “(1) whether MCL 552.23 and MCL 552.401 are inapplicable where the parties entered into an antenuptial agreement; and (2) whether the real estate held by the plaintiff’s limited liability companies, including the marital home, and any income generated by those properties, could be treated as marital assets and, if so, under what conditions.” (Michigan Supreme Court Order Docket Number 150891).

Only the second question raised by the Court is within the jurisdiction of the Business Law Section and is addressed in the amicus brief. The positions of the Section in the amicus brief address this second question are that:

(a) Property owned by a limited liability company (an “LLC”) is not property owned by any individual member of such LLC (Section 504(2) – MCL 450.4504).

(b) Ownership interests in an LLC are referred to as membership interests. Membership interests owned by an individual are personal property of that individual (Section 504(1) – MCL 450.4504). Real estate held by an LLC in which a divorcing spouse has a membership interest, including the marital home, and any income generated by those properties, are not marital assets. The right to receive distributions from the LLC resulting from ownership of the membership interests in the LLC, could be a marital asset depending upon how the membership interests are acquired, how the membership interests are held, and how the provisions of any nuptial agreement between the spouses addresses personal property, in general, or membership interests in an LLC, in particular.

(c) LLC membership interests are not transferrable without the consent of the member(s) of the LLC (Section 506(1) – MCL 450.4506(1)); therefore, a court cannot award one spouse the membership interests of the other spouse in an LLC as part of a divorce judgment. While the statute permits the assignment of membership interests (Section 505(1) – MCL 450.4505(1)), it clearly provides that an assignment does not of itself entitle the assignee to participate in the management and affairs of a limited liability company or to become or exercise any rights of a member – it only entitles the assignee to receive, to the extent assigned, the distributions to which the assignor would be entitled (Section 505(2) – MCL 450.4505(2)). While the court should properly determine the value of the LLC membership interests, it may not assign the membership interests themselves. Instead a court may include in a judgment of divorce that one spouse is the judgment creditor of the other spouse, and grant to the judgment creditor spouse a charging order as contemplated and authorized by the statute (Section 507 – MCL 450.4507). In this manner the economic value of the membership interests in the LLC can be ascertained, and the non-member spouse may obtain a charging order on distributions from the LLC, without disrupting the management and operations of the company.

(d) “Income” should not be used to determine the value of the LLC membership interest as a marital asset. The “income” of an LLC may have different characteristics depending on tax elections made by the LLC (i.e., corporation, partnership or s-corporation). Further, the income of an LLC may not be an appropriate indicia of the value of a membership interest. One cannot assume that the income (“business income” as referenced by the Court of Appeal (“COA”) opinion) of the LLC can be attributed to the owner for these purposes. The focus should be on the value of the membership interest, and on the distributions of the LLC to that owner. The COA’s use of tax terminology to assist it in defining income for purposes of the nuptial agreement is misplaced and may lead to differing (and unjust) results depending on the tax elections of the LLC.

Explanation of the position, including any recommended amendments:

In the case of *Allard v Allard*, the Trial Court should have determined whether the LLC membership interests of the Plaintiff-Appellant were marital property just as it would consider whether any other personal property was marital property. The Trial Court must also consider whether distributions received by the Plaintiff-Appellant from the LLCs should be marital income. The court should not look to the underlying property owned by the LLC, but rather look only to the LLC membership interests themselves and the right to receive distributions by the owner because of those membership interests.

If the court finds that the LLC interests are marital property, then the court may consider the value of the LLC membership interests in determining an appropriate property settlement between the parties. In the event that some of the value of the LLC membership interests must be used to satisfy a division of property, the court may not force the LLC to make the non-member, divorcing spouse a member of the LLC. Instead, the court should confirm the status of the non-member spouse as a judgment creditor in the judgment of divorce and place a charging order against the member spouse’s right to distributions on account of the membership interest so that the economic value of the membership interests can be accounted for without disrupting the management or operations of the LLC.

STANDARD OF REVIEW

The Business Law Section agrees with the Court of Appeals that a “trial court’s findings of fact made following a bench trial in a divorce action are reviewed for clear error. *McNamara v Horner* (After Remand), 255 Mich App 667, 669; 662 NW2d 436 (2003).”² We further agree that the court “reviews *de novo* the proper interpretation and application of statutes. *Brecht v. Hendry*, 297 Mich.App. 732, 736; 825 N.W.2d 110 (2012).”³

² *Allard v. Allard*, 308 Mich. App. 536, 560; 867 N.W.2d 866 (2014) appeal granted, 497 Mich. 1040, 864 N.W.2d 143 (2015).

³ *Id* at 555.

LAW AND ANALYSIS

Background

The owner of a limited liability company (an “LLC”) is generally referred to as a member. A member’s ownership interest in the LLC (“membership interests”) includes the right to receive distributions and the right to vote or to participate in the management of the LLC.⁴ Members of LLCs have additional rights as members, including the right of access to records and a formal accounting and may bring derivative actions in the right of the LLC.⁵ In some ways, membership in an LLC resembles holding stock in a corporation. But in other ways, membership in an LLC resembles being a partner in a partnership.

This dichotomy means that the various aspects of LLC membership interests are not always treated the same as stock in a corporation, nor are they always treated the same as interests in a partnership. Each right must be reviewed in light of the statute to determine whether it is corporate-like or partnership-like in nature and application.

For example, an LLC member is not liable for the LLC’s acts, debts, or obligations.⁶ This protection against personal liability is intended to be the same as that afforded the shareholders of a corporation. It is also generally accepted that the veil of an LLC may be pierced in certain circumstances just as the corporate veil of a corporation may be pierced.⁷ Also, a member’s right to receive profits and distributions is an economic right and is, absent an agreement to the contrary, freely assignable -- just as corporate stock is generally freely assignable.

⁴ MCL 450.4102(2)(q).

⁵ James R. Cambridge & George J. Christopoulos, MICHIGAN LIMITED LIABILITY COMPANIES (ICLE Second Edition 1998, last updated 01/01/2016) Section 6.1.

⁶ MCL 450.4501(4).

⁷ Cambridge at Sections 6.2 and 6.35–6.37.

On the other hand, the right to vote and participate in the management of an LLC is an ownership right that is not assignable, unless approved by all of the members or provided for in an operating agreement that has been approved by all of the members of the LLC.⁸ This is a decidedly partnership concept that is at odds with the “freely-assignable” characteristic we see with corporate stock where the voting rights of a shareholder freely transfer with each stock conveyance.

I. ARE MCL 552.23 AND MCL 552.401 INAPPLICABLE WHERE THE PARTIES ENTERED INTO AN ANTENUPTIAL AGREEMENT?

This issue is beyond the general interests and expertise of the Business Law Section of the State Bar of Michigan and therefore is not address in this Amicus Brief.

II. MAY THE REAL ESTATE HELD BY THE PLAINTIFF-APPELLANT’S LIMITED LIABILITY COMPANIES, INCLUDING THE MARITAL HOME, AND ANY INCOME GENERATED BY THOSE PROPERTIES, BE TREATED AS MARITAL ASSETS AND, IF SO, UNDER WHAT CONDITIONS?

A. Real Estate Owned by an LLC May Not Be Considered Marital Assets

Michigan statute clearly states that a member of an LLC “has no interest in specific limited liability company property”.⁹ Property owned by the LLC is not to be considered as property owned by any individual member of such LLC, and so real estate held by the Plaintiff-Appellant’s LLCs, including the marital home, may not be treated as marital assets.

The bankruptcy court, applying Michigan law regarding LLC membership interests, held that only the membership interest of a member, even in a single-member LLC, is properly part of

⁸ Cambridge at Section 6.2.

⁹ MLC 450.4504(2).

the estate of the debtor-member – not the property owned by the LLC itself. The court expressly acknowledged that under MCL 450.4504(2) even a single member of an LLC “has no interest in specific limited liability company property” and held the bankruptcy trustee could not force the sale of the LLC’s property because it was not included in the estate.”¹⁰

Therefore, as a matter of law, any property owned by the LLCs cannot be considered part of the marital estate and cannot be subject to distribution by the court in an order of divorce. Similarly, the income earned by an LLC also belongs to the LLC, not to the owner of the LLC. The income of an LLC is not income of the marital estate until distributed to the member. This is true even if the owner bears the tax burden for that income.

B. LLC Membership Interests Are the Personal Property of the Owner of Those Membership Interests

Membership interests in an LLC owned by an individual are the personal property of that individual.¹¹ As discussed above, real estate (or any property for that matter) held by a divorcing spouse’s LLCs, including a marital home, cannot be directly treated as a marital asset. But the membership interests in the LLCs themselves are property that may, or may not be, marital assets of a divorcing spouse.

In particular, the right to receive distributions from the LLC, as evidenced by the membership interests themselves, could be treated as marital assets depending upon how the membership interests are acquired, how the membership interests are held, and how the

¹⁰ Cambridge at Section 6.2, quoting *In re Hopkins*, No DG 10-13592, 2012 Bankr LEXIS 801 (Bankr WD Mich Feb 2, 2012). See also *Gattoni v Zaccaro*, No CV 970396081, 1997 Conn Super LEXIS 697, 1997 WL 139410 (Mar 13, 1997); *Brant v Krilich*, 835 NE2d 582 (Ind App 2005) (holding that member’s judgment creditor could not reach assets of LLC); Robert C. Furr & Jason S. Rigoli, *A Debtor’s Membership Interest in an LLC: What the Trustee Receives*, 31 Am Bankr Inst J 38 (2012).

¹¹ MCL 450.4504.

provisions of any nuptial agreement addresses that property. In this regard, the membership interests can be valued like any other personal property owned by a divorcing spouse. To the extent that the personal property represented by the membership interests is determined to be part of the marital estate, then the value represented by such personal property would be subject to division in a divorce decree.

The question is not whether an LLC used marital income in whole or in part to purchase the various property owned by the LLC. Instead, the question is: was any marital property used to acquire the membership interests or contributed to the LLC thereby rendering the LLC membership interests themselves marital property? The use of marital property in the acquisition or support of the LLCs could then, depending on the facts, make some or all of such membership interests held by the Plaintiff-Appellant marital property.

The Court of Appeals correctly concluded that

as a matter of law, the LLCs created during the course of the marriage are separate legal entities and not to be construed, for purposes of interpreting and applying the plain and unambiguous terms of this antenuptial agreement, as being the same as plaintiff “in his ... individual capacity or name.” Accordingly, to the extent any real property or other assets were acquired during the course of the marriage by the various LLCs created during the marriage, we find that their disposition in this divorce action is not governed by the antenuptial agreement.¹²

While the property owned, or the income generated, by each LLC could not be marital property, the membership interests themselves may be. Further, monies paid by an LLC to the Plaintiff-Appellant during the course of the marriage could also be marital property (by being considered marital income).

¹² *Allard* at 563-564.

In this case there is a question of fact as whether the LLC membership interests are marital property under the nuptial agreement between the parties. Whether or not these particular membership interests are part of the marital estate is beyond the expertise and interest of the Business Law Section. Suffice it for us to say that the membership interests could be marital property just as any other personal property may be, or may not be, personal property in any given situation.

C. A Non-Member Spouse May Not Become a Member of an LLC Absent the Consent of the Member(s) of the LLC

A member's interest in an LLC is different from the member's rights as a member. Put another way, there are important differences between the membership interest itself and the rights conferred on a member by virtue of being a member. As it pertains to assignability, a member's property interest in an LLC generally takes two different forms. The first is a right to receive distributions (that is, profits or a return of capital contributed) as a member. The second is the "full" membership interest itself, which is comprised of not only the right to receive distributions, but also all of the other rights and responsibilities of a member as described in the Michigan limited liability company act (the "MLLCA")¹³ and the LLCs own operating agreement. The right to receive distributions is freely assignable. However, the "full" membership interest is not assignable unless the operating agreement provides that it is assignable, or all of the members of an LLC unanimously vote to admit the assignee as a full member. These distinct interests in an LLC will be reviewed in the following two subsections.

¹³ 1993 PA 23; MCL 450.4101 *et seq.*

1. Right to Receive Distributions

The right to receive distributions is described in Section 505(2) of the MLLCA, which is quoted here in full:

(2) An assignment of a membership interest does not of itself entitle the assignee to participate in the management and affairs of a limited liability company or to become or exercise any rights of a member. An assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled.¹⁴

The provision cited above may not be changed by the operating agreement, unlike many other provisions of the MLLCA. The effect and purpose of this provision is to make sure that, without the consent of all of the other members, an assignee does not obtain critical rights to participate in or control the operations of the LLC, such as voting and management rights, and rights to accountings and access to the LLC's books and records.

The right to distributions can be assigned in one of two ways: voluntarily or involuntarily. The right to distributions is voluntarily transferred by means of an agreement between the assignor/member and the assignee. Upon assignment, the assignor/member remains a member of the LLC with all of the rights of membership, except the right to receive distributions.

The only means described in the MLLCA by which the right to distributions is involuntarily assigned is through the charging lien. The creditors of a member may obtain a charging order against a membership interest of that member. Section 507 of the MLLCA describes how a judgment creditor obtains a charging order and describes other critical aspects of the rights of the assignee or holder of the charging order. For this reason, it will be quoted at length:

¹⁴ MCL 450.4505(2).

(1) If a court of competent jurisdiction receives an application from any judgment creditor of a member of a limited liability company, the court may charge the membership interest of the Member with payment of the unsatisfied amount of judgment with interest.

(2) If a limited liability company is served with a charging order and notified of the terms of that order, then to the extent described in the order, the member's judgment creditor described in the order is entitled to receive only any distribution or distributions to which the judgment creditor is entitled with respect to the member's membership interest.

(3) This act does not deprive any member of the benefit of any exemption laws applicable to the member's membership interest.

(4) Unless otherwise provided in an operating agreement or admitted as a member under section 501, a judgment creditor of a member that obtains a charging order does not become a member of the limited liability company, and the member that is the subject of the charging order remains a member of the limited liability company and retains all rights and powers of membership except the right to receive distributions to the extent charged.

(5) A charging order is a lien on the membership interest of the member that is the subject of the charging order. However, a person may not foreclose on that lien or on the membership interest under this act or any other law, and the charging order is not an assignment of the member's membership interest for purposes of section 505(4).

(6) This section provides the exclusive remedy by which a judgment creditor of a member may satisfy a judgment out of the member's membership interest in a limited liability company. A court order to which a member may have been entitled that requires a limited liability company to take an action, provide an accounting, or answer an inquiry is not available to a judgment creditor of that member attempting to satisfy a judgment out of the member's membership interest, and a court may not issue an order to a judgment creditor.¹⁵

The above language makes several things clear. First, if the LLC is served with a charging order that complies with the MLLCA, the judgment creditor is only entitled to distributions to which the member would have been entitled with respect to the membership

¹⁵ MCL 450.4507.

interest, which is the subject of the charging order. Second, the judgment creditor does not become a member of the LLC, and the member that is subject to the charging order remains a member in all other respects. Third, the charging order is a lien on the membership interest that cannot be foreclosed upon. Fourth, the charging order is the judgment creditor's *exclusive remedy* for satisfying the judgment that creditor has against the member. Finally, the above section makes clear that the judgment creditor is not entitled to an accounting or to force the LLC to take action or answer an inquiry. The above language makes clear that the legislature wanted to severely limit the rights of judgment creditors, *to wit*, judgment creditors obtain nothing other than the right to receive whatever distributions the member might have otherwise received, even if no distributions are actually ever made.

2. Rights to Full Membership.

In contrast to obtaining a right to distributions under a charging order, rights to become a full member can only be transferred to a non-member in one of two ways, depending on whether the LLC is a single-member or multi-member LLC. An assignee of a multi-member LLC may only become a full member upon the unanimous vote of all the members entitled to vote, unless the operating agreement provides otherwise. If the LLC is a single-member entity, then an assignee may only become a member "...in accordance with the terms of the agreement between the member and the assignee."¹⁶ The MLLCA clearly provides that the only way an assignee can become a member with full rights is with the unanimous consent or agreement of the existing members, unless the operating agreement (which would also require the approval of all members) provides otherwise.

¹⁶ MCL 450.4506(1).

Some partnership history is fundamental to understanding the MLLCA restrictions on the transferability of membership interests. Unlike the large operations historically undertaken by royal charter or early corporation statute, the partnership normally consisted of a relatively small group of individuals, joining together to operate a closely held trade or business. The success of the venture, and the financial security of each partner, depended on the trustworthiness and diligence of the other partners. Accordingly, partnership common law developed to prevent a stranger from forcing his or her way into the partnership. Partnership common law developed out of respect for, and to encourage, this intimate form of business organization.¹⁷

For instance, partnership law developed the concept that a judgment creditor can receive distributions from the partnership to satisfy the personal debt of a partner in the partnership, but that judgment creditor cannot “step into the partner’s shoes”. The creditor may not participate in the management and operation of the business, because that would be a violation of the inherent nature of the partnership -- partners get to choose their co-owners and the sovereign will not force unwelcome owners into the partnership.¹⁸ In the absence of an agreement to the contrary, no person can become a member of the partnership without the consent of all of the partners.¹⁹

As is the case with partnership law, the MLLCA is clear that a non-member cannot be forced into the membership of an LLC. That is exactly why the MLLCA requires the unanimous consent of the members before a new member or assignee can be admitted as a member. It is also why judgment creditors cannot force the sale of a debtor member’s full interest.

¹⁷ A. Edward McGinty, *Olmstead - A Lever from Member’s Creditor to Full Multi-Member LLC Membership?*, Fla. B.J., March 2011, at 39, 41-42.

¹⁸ *Id.*

¹⁹ 2 Mich. Legal Forms § 3A:98.

3. Application to Cases of Divorce.

In the case of divorce, if there is no voluntary settlement agreement between the parties, it is the Business Law Section's position that the Michigan courts cannot award the non-member spouse a full membership interest in the single member LLC owned by the Plaintiff-Appellant. Rather, only the member spouse's interest in distributions may be required to be assigned.

Presuming such an assignment of distributions is to be mandated, the only means described in the MLLCA for involuntarily assigning a right to distributions is through the charging lien, and Section 507, by its clear language, is only available to judgment creditors.²⁰ The statutory scheme of the MLLCA makes clear that the right to vote, inspect the records, obtain an accounting and otherwise fully participate in the LLC, is only obtained by unanimous consent of the existing members, even in the case of a single member LLC. The dichotomy between rights to distributions and the full membership interest must be preserved as it is an essential element of the MLLCA, just as it has historically been an essential element of partnership law.

The court should not gut these sections of the MLLCA in the case of divorce by allowing the court to order a member, even a single member, to assign his or her full membership interest to the non-member spouse.

While the MLLCA does not expressly provide a mechanism for forcing an assignment of an LLC's owner's right to distributions in the case of divorce, it is within the Court's equitable power to find that the divorcing, non-member spouse is a judgment creditor of the member spouse, if necessary to effect the proper division of marital assets. It may be entirely possible that, once the value of the LLC membership interests which are determined to be marital assets

²⁰ MCL 450.4507.

(if any) is accounted for, a division of assets can be made without needing to resort to the LLC membership interests. But if a division cannot be equitably accomplished without the use of the LLC membership interests, the Court can determine the amount that is owed by the member spouse to the non-member spouse. By naming the non-member spouse as a judgment creditor of the member spouse, the statutory approach provided for in Section 507 of the MLLCA can then be properly utilized. The judgment creditor spouse can then determine whether to seek a charging order or enter into some other settlement to address the amount of the judgment owed.

In this case, there are questions of fact whether: (a) the LLC membership interests are marital property; (b) if the LLC membership interests are marital property, what is the value of that membership interest; (c) whether any distribution made by the LLCs to the Plaintiff-Appellant constitute marital income; and (d) whether any of that marital income remains to be divided (because such marital income may have already been consumed during the marriage). Once these items are determined, then the divorce court can determine the proper division of the marital property. To the extent that the marital property can be divided without having to utilize the LLC membership interests, that would be preferable and much more in keeping with the statutory scheme under the MLLCA. But, to the extent that an equitable settlement can only be accomplished by using the LLC membership interests, then the court can include in the judgment of divorce the amount owed by the member spouse and, in accordance with Section 507 of the MLLCA, attach the member spouse's right to receive distributions in the specified LLC to satisfy that debt.

D. Business Income as Reported on Tax Returns filed by Plaintiff-Appellant Does Not Necessarily Represent Income Actually Received by Plaintiff-Appellant

The Court of Appeals ruled that all income of the Plaintiff-Appellant, including all income in respect of the Plaintiff-Appellant's LLC membership interests as shown on the Plaintiff-Appellant's income tax returns, should have been treated as part of the marital estate. The Court stated that the record was insufficient to make a definitive ruling on what income, if any, was derived from the LLCs in question. Instead of just remanding on this issue, the Court noted that the parties claimed business income on their joint returns, and then noted that there was only \$21,000 in wages, but \$68,000 in personal expenses.

According to the Court of Appeals, this fact "...calls into question whether income treated by plaintiff, and accepted by the Trial Court, as business income generated by the LLCs should be treated instead as marital income subject to division."²¹ Because of this treatment by the Court of Appeals, the nature of the income generated by LLCs becomes important to the analysis. However, the Court of Appeals does not take into consideration the different elections an LLC can make that will, potentially, change the nature of the "income" generated by this entity, as well the manner in which such income is reported for tax purposes.

1. Elections available to Single-Member Limited Liability Companies.

The type of income that a single member LLC generates for tax purposes depends upon how it is classified under the Federal Internal Revenue Code of 1986, as amended (the "Code"). Ever since the check-the-box regulations became effective in January 1, 1997, the single member limited liability company may elect to taxed as (a) a corporation; (b) an s-corporation; or (c) a disregarded entity (the same tax treatment as a sole proprietorship).

²¹ *Allard* at 565.

Each election handles the reporting and paying of tax on income differently. Depending on the classification, the member of an LLC will reflect the income earned by the LLC differently. Therefore, a brief review of the nature of the income reporting should be made.

2. Tax Impact of the Different Elections.

For instance, an LLC that is treated as a disregarded entity would require the member to report all of the revenues and expenses of the LLC on that member's personal tax return. But if that same LLC elected to be taxed as a corporation, then none of the income of the LLC would appear on the member's tax return until it was distributed to the member.

This is to say that one cannot automatically assume that the income reported by an LLC member on that member's tax return represents income actually received by that member. Stated another way, the member must reflect the income earned by an LLC on his or her individual tax return regardless of whether that income, in the form of money or property, was actually received by the member.²² The use of tax terminology by the Court of Appeals in this case is misplaced and could lead to differing results depending on the tax elections of the LLC.

If a single member LLC is taxed as a disregarded entity, the LLC's income, deductions, gains, losses and credits are reported on the member's personal income tax return. The LLC does not file a tax return at all. The net income is reported on Schedule C, supplemental income and loss on Schedule E, and profits or loss from farming activity on Schedule F. Under Michigan tax laws the income and loss of the single-member LLC is similarly "passed through" and reflected on the individual member's Michigan income tax return. It appears from the record that the Plaintiff-Appellant's LLCs were all taxed as disregarded entities since the Court of Appeals

²² This phenomenon is sometimes referred to as "phantom income" because the member must report, and pay taxes on money even though the member has not received any funds.

referred to the Plaintiff-Appellant's business income as reflected on his tax returns.²³ The only place "business income" appears on a Michigan income tax return is a reference to the income as reported on Schedule C.

If a single member LLC is taxed as a corporation, then the LLC files a separate income tax return (that is, the Form 1120). The LLC itself is taxed on the income it earns. The member is only taxed when money or property are distributed from the LLC to the member, to the extent of the earnings and profits of the LLC. If an LLC that elects to be taxed as a corporation does not make any distributions to its member, that member will not have any income to report on his or her individual Federal or State income tax returns.

If a single member LLC elects to be taxed as an S corporation, the income, deductions, gains, losses, and credits are generally "passed through" to the member. The single member LLC will report its income, deductions, gains, losses, and credits on the Form 1120S. The member will then receive a Form K-1 from the LLC with the amount of income or loss that the member must report on his or her personal income tax forms.

3. Distributions, Not Income on Tax Returns, Are the Better Gauge of Potential Marital Income.

As can be seen from the above, if Plaintiff-Appellant's LLCs had elected to be taxed as corporations instead of the disregarded entities we presume they were, there might have been no business income reflected on the Plaintiff-Appellant's income tax returns. The only income that would have been reflected on the Plaintiff-Appellant's income tax returns relating to his LLCs would have been if distributions had been made to him of cash or property from the LLCs. Also, the fact that Plaintiff-Appellant reported substantial business income on his individual tax return does not mean that this business income was distributed to him.

²³ *Allard* at 565.

The above tax analysis highlights the limitations of trying to determine the Plaintiff-Appellant's marital income on the limited record available to it. If the Court believes that this issue is dispositive, we recommend that the matter be remanded for a thorough analysis of the Plaintiff-Appellant's income, its source, the nature of the income and whether it was distributed to the Plaintiff-Appellant or continues to be held by the LLCs in question.

Particularly for an LLC that is treated as a disregarded entity, the better approach to determine the "income" that might be attributable to a marital estate would be to examine the distributions received by the owner. To the extent that income is to be considered as part of a marital estate, distributions from the LLC represents value actually conveyed from the LLC to the owner. Wages, for instance, may become part of a marital estate because the wages represent monies that come into the marriage that may be used by the spouses together to create a marital estate. Distributions from a single-member LLC more closely match this model regardless of the tax election made by the LLC. If income is part of the marital estate, then the court must determine, as a question of fact, the value that was conveyed from the LLC to the member through distributions and how much of that value remains at the end of the marriage.

CONCLUSION

As a matter of law, the property, real and personal, held by the Plaintiff-Appellant's LLCs, and the income generated by that property, should not be part of the marital estate because they are not owned by either spouse. It is a question of fact, however, as to whether the LLC membership interests themselves should be part of the marital estate, although it appears that the nuptial agreement in this case excludes the value of those membership interests from the marital estate. Further, it is a question of fact whether the Plaintiff-Appellant received any distributions from the LLCs that should be considered as marital income, a question which does not seem to have been determined by the Trial Court. Based upon the foregoing reasons and authorities, amicus requests that this Court render a decision consistent with the above analysis.

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Respectfully submitted,

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